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Supreme Court of the United States

No. 239

JAMES A. RHEINSTROM, Executor under the Will of Minna W. Rheinstrom, deceased,

Petitioner,

v.

THOMAS J. CONNER, Collector of Internal Revenue,

Respondent.

No. 240

FIRST NATIONAL BANK, Cincinnati, Ohio, Trustee under the Will of Karl Kiefer, deceased,

Petitioner,

v.

THOMAS J. CONNER, Collector of Internal Revenue,

Respondent.

PETITIONS FOR REHEARING ON PETITIONS FOR WRITS OF CERTIORARI TO REVIEW JUDGMENTS OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

To the Honorable Chief Justice and Associate Judges of the United States Supreme Court:

The petitioners respectfully apply to this Court for a rehearing of their petitions for writs of certiorari denied by this Court as of October 12, 1942:

In denying the petitions for writs of certiorari in these cases, this Court has declined to consider several novel questions of great importance, regarded as crucial by certain Courts of Appeal (see Petition for Certiorari, pp. 12, 13) as well as by the Bar generally.

We appreciate the natural human possibility that this Court, overburdened with the task of disposing of the mass of petitions filed during the summer recess, might not have had the chance to consider sufficiently the questions or their importance. In this application we shall stress those questions in which we think this Court will be most concerned.

In denying this writ of certiorari, this Court

I. Permits the Court of Appeals to give retroactive effect to a taxing statute contrary to express Congressional intent. The whole point in this case revolved about the fact that the cancellation of the stock and the consequent partial liquidation occurred long before the taxing statute (Section 115 of the Internal Revenue Code) was passed.

II. Section 115g of the Internal Revenue Code, designed to prevent schemes to evade taxation, applies expressly to cases where a *cancellation* of stock was had in order to effectuate a scheme. To apply the prohibition of the statute to "distribution" only, where the cancellation itself was innocent is to rewrite the statute. If it is conceivable that Congress might have covered "distribution" alone into the interdictions of the statute, had the matter been called to its attention, then we have a *casus omissus* which the courts should not supply. The matter is for the Legislature. An example of an analogous omission and the improper supply by the lower courts of corrective legislation was *Maas* v. *Higgins,* relating to an inheritance tax on income received by an executor during the running of the one year optional plan of appraisement. This Court allowed

certiorari and corrected the assumption of legislative power by the Court of Appeals in *312 U. S. 443* (Mr. Justice Black and Mr. Justice Douglas dissenting). This Court said, as we respectfully state the Court should say here:

> "If Congress intended the result for which the Government contends . . . it would have been a simple matter to so state."

III. (a) The Court of Appeals below denied a rehearing in opposition to the express holding of this Court (Petition, p. 11). This Court has held that when a Court of Appeals decides a case on a point not raised by the litigants, a rehearing is in order to enable the party prejudiced to have his day in court. The Court below decided these cases under favor of Section 115g of the Internal Revenue Code, which section the Government sedulously avoided, nor was the section ever mentioned until in the opinion of the court below.

This Court as late as 1939 has granted certiorari on this very ground (*LaTulle* v. *Scofield,* 308 U. S. 415).

(b) The Court of Appeals presumed to find facts, not found by the trial court, and decided the case on a ground never raised or argued. Courts of review do not find facts. The primary facts were stipulated and the statute itself draws the ultimate fact.

IV. The statute itself defines partial liquidation to be the result of a cancellation of stock. (Section 115i.) There is no room for the Court to "find" as a fact whether or not the liquidation as such is "properly" chargeable to capital account, if the propriety of the cancellation itself is not challenged, and the amount of the cancellation money is not in issue.

V. The decision of the court below is at variance with the decisions of other Courts of Appeal, as the lower court concedes. (R., p. 97 ff. Also Pet., pp. 12, 13.) See *Patty* v.

Helvering, 98 Fed. (2d) 717, 719, wherein L. Hand, J., remarked,

> "We shall continue to follow *Com'r* v. *Quackenbos,* 78 Fed. (2d) 156, until the Supreme Court makes authoritative a different interpretation."

The appellants are stockholders in a corporation which in 1914, long before Section 115 was passed, reduced its capital, called in and cancelled $100 par value stock under State authority, received the stock from the stockholders and issued new stock of the same par value, but a smaller number of shares. There is nothing in the record to show bad faith respecting this cancellation. The operation necessarily involved a debt to the stockholders whether the corporation's books set up that debt properly or not. There can be no question of motive or interest in respect to this cancellation, one way or the other, so far as Section 115 of the Internal Revenue Code or any section of that code is concerned, for the simple reasons that the sections in question had not been passed or thought of at that time. One cannot intend to evade a law that does not exist. So far as Section 115 is concerned, or any other law or moral, that cancellation was perfectly innocent of any purpose to evade the Revenue Laws or any other law.

So much is conceded by the lower court at least regarding the *cancellation* alone. That being so, there is no room for any finding of fact by the Circuit Court of Appeals (assuming that that court had any right to find facts, which in our brief we have shown by this Court's holdings, it has not) as to the evasion of the taxing laws, as envisioned by Section 115g. The cancellation being thus innocent, there was no fact left for the courts below to pass upon under Section 115g. All of the cases where stock *not originally issued as a stock dividend* was cancelled and Section 115g was held to apply, were cases where the *cancellation itself*

took place after Jan. 1, 1926, the date of the precursor of the 1934 Section of the Act.

There was left, therefore, if anything was left, which we deny, only one fact for the trial court to find in any construction of Section 115g, and that was whether the *distribution* was innocent under Section 115g. We have insisted that under Section 115g, it is the *cancellation* that must be bad, or at most the cancellation *and* distribution. *Both* have to be part of a scheme to avoid taxation. But passing that point, and postulating now that though the *cancellation* was innocent of any juggling contemplated in Section 115g, and that a debt was thus owed the stockholders but that the trial court had the right to judge the propriety of the *distribution,* we contend, and have contended, and the decisions of this Court bear us out (see Petition, page 16 and note), that any Board of Directors finding itself in possession of funds more than enough to pay any debt or any refund to stockholders which is due them, plus enough more to pay dividends on the stock, has the right to withhold the dividend and pay the debt. Indeed, the creditor stockholders could, if they wished, force the payment of the debt.

No court has the right, though it have the power, to find as a fact merely from evidence of the possession of funds more than enough to do both things, that the choice to pay the debt to the stockholders is subversive of Section 115g of the Revenue Code; surely, at least in the case of a cancellation of stock before January 1926, not previously issued as a stock dividend.

This choice constitutes a "partial liquidation" under the statute and by the very terms thereof, and it is expressly protected from taxation as a dividend by Section 115c of that Code. Under that section the phrase "which is properly chargeable to capital account" does not leave to the courts any fact finding authority as to "propriety,"

of the liquidation *as such,* but only as to the amount of it, and here there was no issue as to the amount. *The section itself defines that propriety* when the distribution is relegable to partial liquidation, which by definition in Section 115i of the Revenue Code took place here, and *ex hypothesi* the Board of Directors had the right in this case to relegate the distribution to cancellation of the stock whenever the Board or its creditor stockholders chose, whether in 1914 or in 1934.

This was recognized in *Foster* v. *U. S.,* 303 U. S. 118, where it was to the interest of the Government to recognize the partial liquidation. What is sauce for the goose should be sauce for the gander.

If the distribution is earmarked by the corporation as the payment of a rightful debt contracted before Section 115g was passed, the recipient is receiving capital, not income, and for the lower court to call capital income, is to take property without due process of law, and also to violate the income tax amendment in the Constitution (*Eisner* v. *Macomber,* 252 U. S. 189). But even if the overruling of the *Eisner* case is in the offing, and even if a statute could make capital income for the purpose of taxation, the statute here negatives any such intention when it says in Section 115i:

> "As used in this section 'amounts in partial liquidation' means a distribution by a corporation in complete cancellation of a part of its stock."

None of the factors mentioned by the lower court, such as the continuous possession of enough funds to pay this debt through all the years, or the fact that the corporation used the stockholders' money in the business, or the fact that the stockholders received no interest on their debt, have anything to do with the rightness or wrongness of the *cancellation* of the stock under Section 115, or with the

cancellation *and* distribution to the stockholders of the money that was due them. Neither this Court nor any other court, except the court below, has applied these factors to a cancellation before January 1, 1926, of stock not issued as a stock dividend.

It all comes down to this: Section 115g plainly seeks to reach any *cancellation* of stock *cancelled* with the *purpose* of later paying for that cancellation out of otherwise taxable profits. In this case there was no justiciable possibility of such an interdicted purpose, because the statute taxing the cancellation money had not yet been passed.

It is no doubt true that the lower courts probably felt that because such a long time had elapsed before the Directors elected to pay this debt, and because they picked out a year when the corporation made a great deal of money, somehow or other the stockholders who received this money so belatedly ought to pay a tax on it as a dividend, and perhaps the statute should have been written to provide that they should, if that could be done constitutionally. Perhaps the statute should have provided in some appropriate form that though a cancellation of stock at the time it was made was not in violation of Section 115g, if payment of the debt was delayed unreasonably long, a belated distribution of the cancellation money should be taxable as a dividend. But our point has always been that the statute makes no such provision, and it is not up to the courts to find facts in violation of the statute, so as to make it read as the courts think it ought to read.

Furthermore, even if the statute had read that way, then the proffered testimony of the plaintiff below should have been admitted for the record, tending to show that the belatedness was *not* unreasonable.

The construction of Section 115g as to whether the evasion of taxes is relegable to the cancellation alone, *or*

whether if the cancellation is innocent, the courts can weigh the validity of the distribution alone has never been passed on by this Court, though various Judges of the Courts of Appeal have hoped that it would be.

We respectfully urge that this Court re-examine the petition for certiorari, and that it take this case and iron out the many inconsistent and cloudy decisions of the various Courts of Appeal as set forth in our brief, inconsistencies which the court below in its opinion recognizes.

Respectfully,

THOMAS C. LAVERY,
A. JULIUS FREIBERG,
Attorneys for Petitioners.

Thomas C. Lavery and A. Julius Freiberg, counsel for petitioners, hereby certify that the foregoing Petition for Rehearing is made in good faith and not for purposes of delay, and on grounds believed to be valid and substantial.

THOMAS C. LAVERY,
A. JULIUS FREIBERG.